

Letter of Findings Number: 01-20130646
Individual Income Tax
For Tax Year 2011

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded by the publication of another document in the Indiana Register.

ISSUE

I. Adjusted Gross Income Tax – Liability.

Authority: IC § 6-3-1-3.5(a); IC § 6-3-1-10; IC § 6-3-2-1; IC § 6-3-2-2.8; IC § 6-8.1-5-1(c); Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); [45 IAC 3.1-1-66](#); 26 U.S.C. § 1361; 26 U.S.C. § 1366; 26 U.S.C. § 62.

Taxpayers protest the imposition of adjusted gross income tax.

STATEMENT OF FACTS

Taxpayers, also referred to as "Husband" or "Wife," are individuals and residents of Indiana. Husband is a shareholder in an S corporation ("S-Corp.") which is domiciled in Indiana. S-Corp. is a partner in a partnership ("Partnership") which is not domiciled in Indiana. For the tax year 2011, Partnership provided S-Corp. with a federal Schedule K-1 (Partner's Share of Income, Deductions, Credits, etc.) ("federal K-1") reporting approximately \$3 million in federal income. Partnership also provided S-Corp. with a Schedule IN K-1 (Partner's Share of Indiana Adjusted Gross Income, Deductions, Modifications, and Credits) ("IN K-1") reporting approximately \$1 million in Indiana income. Consequently, Partnership reported a difference between federal income and Indiana income for S-Corp. of approximately \$2 million (the "Difference"). Partnership did not provide S-Corp. with any other state Schedule K-1s reporting income in other states.

S-Corp. issued a 2011 federal K-1 and 2011 IN K-1 to Husband as a shareholder in S-Corp. Both forms reported approximately \$3 million as ordinary business income, matching the amount reported on S-Corp.'s federal K-1. S-Corp. then issued an amended IN K-1 to Husband. The amended IN K-1 reported approximately \$1 million in ordinary business income, matching the amount reported on S-Corp.'s IN K-1.

Taxpayers filed their 2011 Indiana Full-Year Resident Individual Income Tax Return (Form IT-40). On it they included the income reported by S-Corp. on the federal K-1 issued to Husband in their adjusted gross income (approximately \$3 million). Taxpayers claimed a deduction on their Form IT-40 for the Difference, approximately \$2 million. Taxpayers stated that this was a deduction for "[Partnership] IN K-1 Adjust (See Attached)." Taxpayers included a spreadsheet with their Form IT-40 attempting to explain the deduction. The Indiana Department of Revenue ("Department") did not accept the deduction and adjusted Taxpayers' income to match the Department's and Internal Revenue Service's records.

Taxpayers reported an overpayment on their 2011 Form IT-40. Taxpayers elected to have this overpayment applied to their next year's tax liability. The Department's adjustment of the Taxpayers' Indiana adjusted gross income reduced the Taxpayers' reported overpayment. The amount the Department reduced Taxpayers' overpayment represents the Department's proposed assessment of tax. Taxpayers protest the Department's proposed assessment of tax. An administrative hearing was held, and this Letter of Findings results. Additional facts will be provided as needed.

I. Adjusted Gross Income Tax – Liability.

DISCUSSION

Taxpayers protest the Department's proposed assessment of tax. All tax assessments are prima facie evidence that the Department's claim for the tax is valid, and the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). The issue before the Department is whether Taxpayers have met their burden to prove the Department's proposed assessment of tax is incorrect.

Except in specific circumstances, corporations electing subchapter S status pursuant to section 1361 of the Internal Revenue Code ("S corporations") are exempt from the Indiana adjusted gross income tax. 26 U.S.C. §1361, IC § 6-3-2-2.8, [45 IAC 3.1-1-66](#); See also IC § 6-3-1-10, IC § 6-3-2-1(b). For Indiana income tax purposes, the adjusted gross income of S corporations is passed through to its shareholders, and "shareholders are taxed on their distributive shares of income at the individual income tax rate." [45 IAC 3.1-1-66](#); see also 26 U.S.C. §1366. Shareholders, including Indiana resident individuals, are taxed on their distributive shares of income at the individual income tax rate. *Id.*

Indiana imposes a tax on the adjusted gross income of every resident individual. IC § 6-3-2-1(a). For individual Indiana residents, the calculation of Indiana adjusted gross income begins with the federal adjusted

gross income. IC § 6-3-1-3.5(a). Federal adjusted gross income for an individual is defined in Section 62 of the Internal Revenue Code as gross income minus certain deductions. 26 U.S.C. § 62. Indiana law provides for additional modifications to a resident individual's federal adjusted gross income. IC § 6-3-1-3.5(a). Thus the federal adjusted gross income as defined in Section 62 of the Internal Revenue Code adjusted by Indiana specific modifications is the Indiana adjusted gross income for an individual resident. IC § 6-3-2-1(a).

S-Corp. is domiciled in Indiana. Taxpayers are individuals and residents of Indiana. S-Corp. is an S corporation whose adjusted gross income tax is passed through to its shareholders. Husband is a shareholder in S-Corp. and is taxed on his distributive share of S-Corp.'s income at the individual income tax rate. Taxpayers properly included Husband's distributive share of the 2011 income from S-Corp. on their 2011 Form IT-40. Taxpayers then claimed a deduction on their Form IT-40. This deduction is primarily made up of the difference between the 2011 federal K-1 and the amended IN K-1 issued by S-Corp. to Husband. Taxpayers stated on the Form IT-40 that this was a deduction for "[Partnership] IN K-1 Adjust (See Attached)." Taxpayers included a spreadsheet with their Form IT-40 attempting to explain the deduction. Taxpayers argue that this is a proper deduction.

However, Taxpayers have failed to adequately support their argument that the deduction is allowed by federal or Indiana law. Taxpayers rely on the 2011 IN K-1 issued by Partnership, but they supply no other state Schedule K-1s (or a similar form) issued by Partnership to S-Corp. showing that the Difference was reported as income elsewhere. Additionally, they provide no documentation from Partnership explaining the reason why the income reported on the K-1 forms issued to S-Corp are different. Taxpayers have not provided documentation to support the assertion that the deduction is authorized by Section 62 of the Internal Revenue Code. They have not shown the deduction is an allowable modifications to federal adjusted gross income provided for in IC § 6-3-1-3.5(a). Finally, Taxpayers have not shown that the proposed deduction is permitted by Indiana or federal case law. Consequently, Taxpayers have not met their burden to prove the Department's proposed assessment is incorrect, and Taxpayers' protest is respectfully denied.

FINDING

Taxpayers' protest is respectfully denied.

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